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CHARLES ELMORE

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1928.

INTERNATIONAL SHOE COMPANY,
Appellant,

vs.

STRATTON SHARTEL,
Attorney-General, et al.,
Appellees.

No. 579.

PETITION OF INTERNATIONAL SHOE COMPANY FOR REHEARING.

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PETITION OF INTERNATIONAL SHOE COMPANY FOR REHEARING.

The International Shoe Company, appellant, files this, its petition for rehearing, and presents the following:

1. This Court is in error in its opinion in stating "that the decision in the Pierce case in effect fixes the rate of taxation at 5 cents on each share of non-par stock employed within the state, regardless of its actual value."

The tax under the Missouri law is not a tax upon shares, but is a tax of one-twentieth of one per cent of the par

value of outstanding capital stock and surplus employed in business within the state. Unlike other franchise tax statutes heretofore construed by this Court, THE TAX HERE is based on outstanding **capital stock and surplus**. The tax on the outstanding capital stock arbitrarily fixed at $100.00 per share is one-twentieth of one per cent; the tax on the surplus is one-twentieth of one per cent, and it is not, either actually or in effect, "5 cents per share on the non-par stock employed within the state," because surplus is taxable as well as capital stock.

The Missouri Supreme Court, in the Pierce case, says (2 S. W. [2d], l. c. 794):

> "It (the statute) provides with respect to the first (par corporations) that the stock shall be computed on the par value of the capital stock **and surplus**; with respect to the second (non-par corporations), that it shall be computed on an arbitrary valuation of $100.00 per share **and** surplus." (Emphasis ours.)

This is quite different from a tax "of 5 cents per share on each share of non-par stock employed within the state."

2. The Court erred in its opinion in holding that: "The market value of appellant's stock does not appear and no foundation is laid for assailing the tax as so excessive as to be a denial of due process."

The bill of complaint sets forth its return filed with the State Tax Commission. The return recites (Rec., pp. 7-8):

"6. Capital stock issued and outstanding $46,082,631.09
12. Clear market value of property and assets in State of Missouri..... $52,956,249.12
13. Clear market value of property and assets without the State of Missouri $44,212,827.12
14. Clear market value of total property and assets..... $97,169,076.24"

The bill continues:

"The information contained in said report is true. It thus appears, and complainant avers the facts to be, that complainant has a total outstanding or paid-in capital stock, or stated capital, of $46,082,631.09, a surplus of $51,086,445.15, total property and assets of the value of $97,169,076.24, of which there are in the State of Missouri $52,956,249.12, or about fifty-four per cent (54%) of its total properties and assets" (Rec., p. 8).

The foregoing facts are admitted.

Thus the market value of appellant's assets in Missouri and outside Missouri **does** appear.

The value on the market of the "shares" of stock is of no consequence whatever. The statutes here in question do not even remotely refer to market value of shares of stock. The shares belong to the stockholders, and they alone are concerned with their market value. The market value is their property, not the corporation's. The

situs of all the shares of stock may be beyond the state, in which event, if the tax be based thereon, it is based on property beyond the limits of the state. The assets, the capital, belong to the corporation, and it is the assets that are used in its business, and their value that determine the tax, and not the market value of the shares of stock. The question is, what is the value of appellant's outstanding capital stock and surplus (property) actually used in its business in Missouri; **that value is admitted**, and is $52,956,249.12; that is all that is contemplated by the statute (Marquette Hotel Co. v. State, 282 Mo. 213; State ex rel. Williams, 284 Mo. 456; State v. Freehold Inv. Co., 305 Mo. 88). By applying the "basis or unit of measurement" of the Pierce Petroleum case, this admitted value is given a purely fictitious value of $208,000,000.00, with a resultant tax of $104,000.00. Clearly, this is confiscation, a taking of property without due process.

3. Further, the tax is confiscatory and denies appellant due process, because:

The Supreme Court of Missouri in the Pierce Petroleum case holds that the Stock Corporation Act relates only to domestic corporations, and that in section 12 it in effect supplements and amends Section 9836 of the Franchise Tax Law as to **domestic** non-par corporations organized under that act. It concludes that since the act thus relates to domestic corporations, "preferential treatment" would be given to foreign non-par corporations if they

should not be required to pay taxes on the same basis; and, therefore, not because the act so provides, but to avoid "preferential treatment" the Court held that its provisions in this respect should be applied to foreign non-par corporations. In other words, **there is no statute in Missouri which requires that the stock of foreign non-par corporations shall be given a value of $100.00 per share for franchise tax purposes.** The tax in this case has been assessed on the basis complained of because the statute required it to be so assessed in the cases of **domestic** non-par corporations. Clearly, to impose a tax without any statutory warrant to do so is a taking of property without due process.

4. The Court erred in holding that, for the reasons set forth in No. 601, New York v. Latrobe, equal protection of the laws was not denied.

(a) The Missouri statute is not a tax at a flat rate per share when apportioned to assets within the state. But, as stated by the Supreme Court of Missouri, it "contemplates a tax upon the right to do business in accordance with the property actually used in the business" (State v. Tax Commission, 282 Mo., l. c. 224), and is one-twentieth of one per cent of the property (capital stock **and surplus**) **actually** used in its business in Missouri. Of course, assigning an arbitrary value of $100.00 per share to the non-par stock will never determine how much capital and surplus are **actually** used in the state, except in the almost

unheard of instance where the non-par stock has been issued at $100.00 per share.

(b) It is not "equally true of corporations having par-value stock" that their tax will "bear little relation to the property and business of the corporation within the state." The application of the Missouri formula (capital stock and surplus employed in the state equals percentage of property in the state to all property) to par-value corporations will always unerringly determine precisely the property actually used in its business in the state, save in the exceptional case where the corporation's total assets have fallen below the par value of its capital stock.

Usually the assets of a going corporation equal or exceed the par value of its capital stock. Rarely does a corporation's statement disclose assets less than its capital stock. When a corporation's assets have fallen below its capital stock one of two things generally occurs, and occurs quickly. Either it fails and passes off the commercial stage, or it rehabilitates itself and builds up its assets to or above its capital stock. It is a fair presumption, therefore, that the assets of a going corporation equal the par value of its capital stock, whether that par value be $100.00 or $50.00 or $5.00 a share, and, therefore, the application of the Missouri formula to them generally yields a tax based upon the property actually used in business in the state.

But there is no presumption whatever that the assets of a non-par stock corporation equal its stock at $100.00 per

share. On the contrary, the presumption is that they do not. Indeed, one of the purposes, and perhaps the chief purpose, of non-par stock is to enable the corporation to sell it for varying sums below, and usually far below, $100.00 per share. To give it a value of $100.00 per share for the purpose of assessing the Missouri Franchise Tax will never determine the property actually used by it in its business in the state, save in the extremely exceptional case (if there be one) where the company has issued its non-par stock for $100.00 per share. It follows that giving an arbitrary value of $100.00 per share to stock of a non-par corporation, and then applying the Missouri formula, yields a tax that bears no relation whatever to the property used by the corporation in its business in the state, and necessarily denies such corporations, as between themselves, the equal protection of the law.

(c) The "kind and number of shares with which a foreign corporation is permitted to carry on its business" is a privilege granted to it by the state of its incorporation. If this privilege may be taxed by the State of Missouri, it may be destroyed by the State of Missouri. It is not, therefore, "a proper element" to be taken into account in fixing a tax on the privilege of doing business within the state. Furthermore, section 9836 does not contemplate the inclusion of such privilege as an element to be taken into account in fixing the tax. The tax is to be measured "in accordance with the property actually used in the business in the state" (State v. Tax Commission, 282 Mo., l. c. 224).

As here construed, "the act has no tendency to produce equality, and it is of such a character that there is no reasonable presumption that substantial equality will result from its application" (Airway Co. v. Day, 226 U. S., l. c. 85).

5. The Court erred in holding that "the tax is a privilege and not a property tax," and, therefore, that it "does not operate to tax property or business without the state."

This Court has frequently held that "the substance and not the shadow" determines the character of the tax (Postal Telegraph and Cable Co. v. Adams, 155 U. S. 688), and that, whether the imposition is an excise or a tax on property beyond the jurisdiction, "is determined by its **effect** and **necessary operation**" (Western Union Telegraph Company v. Kansas, 216 U. S. 1; Minnesota v. Barber, 136 U. S. 113; St. Louis S. W. Railway Co. v. Arkansas, 235 U. S. 350; Kansas City, F. S. & M. R. Co. v. Botkin, 240 U. S. 227, l. c. 231; Ohio Tax Cases, 232 U. S. 576; Looney v. Crane, 245 U. S. 178; International Paper Co. v. Mass., 246 U. S. 135; Airway Elec. Appliance Corporation v. Day, 266 U. S. 71). It is not what the statute or the formula says, but what it does that determines the character and validity of the tax.

Though this tax be called a franchise tax, its **effect** and **necessary operation** is to tax $208,000,000.00, arbitrarily and fictitiously assumed to be appellant's capital stock and surplus used in Missouri, one-twentieth of 1 per cent,

though in truth and in fact, and as is **admitted**, appellant uses in Missouri but $52,000,000.00 of outstanding capital stock and surplus. If, to the extent that it is a tax upon the excess beyond the property actually used in Missouri, it is not in **effect** and **practical operation** a tax on appellant's $44,000,000.00 of property beyond Missouri, then we are unable to understand what would constitute a tax upon that extraterritorial property.

6. It is presumed that when the Legislature of a given state legislates it has in mind the construction of that law by its Supreme Court, and, if that law is to be amended, that the Legislature will have in mind the particulars in which the law should be amended or referred to in order that the Legislature and the public may know it is being amended. The Supreme Court of Missouri, in the case of State ex rel. Standard Tank Car Co. v. Sullivan, 282 Mo. 261, held that Sections 9836 and 9838 of the Missouri Franchise Tax Law applied to foreign corporations having shares of no-par stock, and that they could be taxed in conformity with the existing law. The Stock Corporation Act passed in 1921 was solely in reference to the formation of domestic corporations in the State of Missouri with no-par shares. In its title it did not purport to amend, in any particular, any law or franchise tax as to foreign corporations, and the Supreme Court of Missouri in its decision in the Pierce case (2nd S. W. [2d], l. c. 795) does not suggest that the law as amended applied to foreign corporations, but says:

> "The very act (i. e., the Non-Par Stock Act) which authorizes a domestic corporation to issue shares of stock without nominal or par value provides that every such share shall be considered the equivalent of a share having a par value of one hundred dollars for the purpose of computing the annual franchise tax. In accepting the privileges granted such a corporation voluntarily assumes the burden imposed."

This relates solely to **domestic** corporations, but the Court goes further and says:

> "And, of course, a corporation of another state desiring to do business in this state is not entitled to preferential treatment in that respect."

The Court thus admits that section 12 did not amend section 9836 as to **foreign** corporations. When the Court does apply a domestic law to a foreign corporation it is then going into the legislative field rather than judicial, and when the caption of the act does not show that the subject legislated upon by the Court is covered, the act certainly is subject to constitutional objection that the title does not cover the field legislated upon.

7. The Supreme Court of Missouri in the Pierce case holds that the Stock Corporation Act relates only to domestic corporations, and that in section 12 it, in effect, amends Section 9836 of the Franchise Tax Law as to **domestic** non-par corporations organized under the said Stock Corporation Act. It concludes that since the act

thus relates to **domestic** corporations "preferential treatment" would be given foreign corporations if they should not be required to pay taxes on the same basis and, therefore, not because the act so provides, but to avoid "preferential treatment" the Court held that section 12 should be applied to foreign non-par corporations. Since, therefore, the act does not relate to **foreign** corporations, its title cannot relate to foreign corporations, and if section 12 is to be arbitrarily applied to foreign corporations then we are applying the act in a manner not contemplated or expressed in the title, in violation of Article IV, Section 28 of the Missouri Constitution.

8. The title to the Stock Corporation Act is not general in its terms; it goes into specific details and attempts to state with particularity as to what the bill is intended to cover and include, making provision for the formation, reorganization, merger or consolidation of corporations, for the issuance of either or both preferred or common shares without nominal or par value, regulating the same and prescribing the method of determining the number of shares and capital of corporations issuing shares in such manner. The word "regulate" has been defined in the State of Missouri, and it does not include or cover a tax for revenue purposes.

State v. Ashbrook, 154 Mo. 375;
City of Carthage v. Rhodes, 101 Mo. 175;

Pierce City v. Hentachell, 210 S. W. 31;
Ex parte Smith, 251 Mo. 111;
Cooley on Taxation, Sec. 125, p. 293;
Postal Telegraph-Cable Co. v. Adams, 155 U. S. 688.

That the title of the act does not clearly indicate the subject—that is, an intent to amend the Franchise Act—is evidenced by the fact that the taxing authorities of the State of Missouri for six years did not discover that the act applied or was intended to apply to the annual franchise tax to be paid by either domestic or foreign corporations.

9. Even in states where the franchise tax laws impose the tax only on capital stock a wide difference or inequality results from applying an arbitrary value to nonpar-value shares, and at the same time applying to par-value shares the amount received for such shares by the corporation, because $100 per share is now seldom the par value of such shares and is not the amount received by the corporation for par-value shares, and unless $100 per share be received for both classes of shares inequality inevitably will always result. In Missouri surplus must be included as a basis for the tax, so that on nonpar-value shares the result is a greater inequality.

10. Different fees or charges may be imposed for a privilege based on classification of subjects, but where the basis of the charge is money value, either of capital stock and surplus or property, there can be no justification for valuing a dime at a dollar under the guise of classification

—the result is confiscation and a taking of property without due process.

11. The assignment to non-par shares of an arbitrary value of $100.00 each, and multiplying the number of shares by $100.00, gives to the outstanding capital stock so determined a value many times its par value. In this case ten times its true value. As surplus used in Missouri must be included, capital and surplus is valued at more than four times the par value of the entire outstanding capital and surplus of appellant corporation; hence, of necessity, it results in a tax upon appellant's property beyond the State of Missouri. This arbitrary valuation of outstanding capital stock and surplus results in a greater tax on appellant than a tax based on its entire outstanding capital stock and surplus, which method of taxation was condemned in the case of Looney v. Crane, 245 U. S. 178. In that case the annual franchise tax was based on outstanding capital stock and surplus, and the qualification tax was based on authorized capital stock and surplus. As all authorized stock was issued the question of unissued stock was not presented, but this Court held both taxes unconstitutional. The effect of the decision in the instant case is to overrule Looney v. Crane, International Paper Co. v. Massachusetts, 246 U. S. 135, and Airway Co. v. Day, 266 U. S. 71.

12. It has been decided by this Court that the only privilege granted a foreign corporation by a state when it is permitted to do business within that state is the privilege of doing the business authorized by its Articles of Incorporation, and that an annual franchise tax for this privilege must bear some relation to the privilege granted (Airway Elec. Appliance Corp. v. Day, 266 U. S. 71.

No added charge can be made for being a corporation, or for the right to issue shares of stock without par value, or for the number of shares issued; for those powers were granted by the state of its incorporation (Southern Railway v. Green, 216 U. S., l. c. 417-418; Airway Co. v. Day, 266 U. S., l. c. 83).

The number of no-par value shares is not an indication, and does not purport to be a representation as to the amount of its capital (Airway Elec. App. Co. v. Day, 266 U. S., l. c. 83).

13. The capital stock and shares of the capital stock are distinct things. The outstanding capital stock of a corporation belongs to the corporation, whether it is paid in money, property or labor; it is the amount received for the shares of stock issued, and is a fixed and definite amount set up on the books of the corporation (and is required to be set up under the laws of the state of its incorporation). It is neither increased nor diminished by losses or gains made by the corporation (Farrington v. Tennessee, 95 U. S., l. c. 686). This is true of corpora-

tions having no-par value shares and those having par value shares. The capital stock and surplus is used by the corporation in its business. The shares of stock issued are not used; they belong to the stockholders and represent the ownership by the holders of an aliquot part of the corporate assets after debts are paid. The market value of shares is the value of the stockholders' property, not the corporation's. No corporation can pay dividends out of capital stock, whether its shares have a stated par value or no stated par value.

The liability for unpaid subscriptions on par-value shares and no-par-value shares is exactly the same; there is no distinction. In each instance it represents the difference between the amount actually paid on the shares and the value or amount agreed to be paid at the time of subscription or sale by the corporation; it is definitely established by the contract of subscription or purchase. No foreign state, by franchise tax law, can increase or diminish this liability.

14. There is no difficulty, according to the Supreme Court of Missouri, in determining the franchise tax on a no-par-value corporation, because its books and reports reflect the total amount of the par value of its outstanding capital stock and its surplus, and the total amount of its investment in Missouri, so that there can always be apportioned to the state a proper amount as a basis for taxation (State v. Freehold Investment Co., 305 Mo. 88;

State ex rel. Standard Tank Car Co. v. Sullivan, 282 Mo. 261). Therefore, since the Missouri statute imposes the tax on surplus, as well as capital, and since these amounts are always definitely fixed and ascertainable, there is no necessity nor justification for arbitrary classification or valuation.

15. Classification may be made for the purpose of taxation, either excise or ad valorem, but such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the classification imposed, and arbitrary selection cannot be justified by calling it classification (Southern Railway Co. v. Green, 216 U. S., l. c. 417-418).

16. It is not a reasonable classification to divide foreign corporations for annual franchise tax fees into two general classes; one, those whose shares have a stated par value and base the tax on par value of outstanding capital stock; the other, those whose shares have no stated par value, and arrive at par value of capital stock, for franchise taxes, by multiplying the issued number of shares by $100.00 per share, irrespective of the outstanding capital stock or the amount paid for the shares of stock, because if that be done the tax is not measured by the real outstanding capital stock and surplus justly apportioned to the state.

17. It is no more arbitrary and confiscatory to fix the franchise fees for foreign corporations whose corporate

names begin with the letter "C" at double the amount which shall be paid by corporations whose corporate names begin with the letter "A" for the privilege of doing business in a given state, than it is to say that the capital stock of a foreign corporation which issued shares having a stated par value shall be the basis on which a franchise tax is charged, irrespective of the number of shares issued by it, and then say that the number of shares of a corporation which issued shares having no stated par value, multiplied by $100.00, shall be its outstanding capital stock and the basis of its franchise tax, when such arbitrarily fixed capital stock is nine times its actual outstanding capital stock and four times its capital stock and surplus, and yet that is the situation here.

18. A state which grants foreign corporations the privilege of doing business within its borders grants the same and no greater privilege to every foreign corporation, irrespective of whether its capital stock is represented by shares of a stated par value or no par value. It can grant no corporate powers to either corporation as to the kind or number of shares issued or to be issued. It can refuse foreign corporations the privilege of doing business within its borders, but, when the privilege is granted, then it cannot arbitrarily discriminate and charge different amounts for this privilege, because one corporation is incorporated under the laws of Delaware and another is incorporated under the laws of Pennsylvania, and any discrimination

between foreign corporations issuing par-value shares and those issuing no-par-value shares for the privilege of doing business in a state, based on a valuation of its capital stock and surplus at four times its actual amount, is arbitrary, confiscatory, and taxes property beyond the state, deprives the corporation of property without due process of law, and deprives it of equal protection of the law, and violates the Fourteenth Amendment to the Constitution.

19. Any measure or basis of taxation, whether excise or ad valorem, which values property, whether it be the outstanding capital stock and surplus or real estate, of a corporation at more than four times its admitted actual value is not classification but confiscation, and is a denial of the equal-protection and due-process clause of the Fourteenth Amendment to the United States Constitution.

Union Tank Line Co. v. Wright, 249 U. S., l. c. 282.

20. This Court at one time held that a state could impose any exaction it saw fit on a foreign corporation for the privilege of doing business within the state.

Horn v. Silver Mining Co. of New York, 143 U. S. 305;
Doyle v. Continental Ins. Co., 94 U. S. 535;
Security Mutual Life Ins. Co. v. Prewitt, 202 U. S. 246.

But this holding was thereafter expressly overruled in:

Looney v. Crane, 245 U. S. 178;
International Paper Co. v. Mass., 246 U. S. 135;

Terrall v. Burke Construction Co., 257 U. S. 529;
Hanover Fire Ins. Co. v. Harding, 272 U. S. 494;
Air-Way Co. v. Day, 266 U. S. 71,

in each of which cases it was held that the exaction was subject to the rights granted by the Constitution of the United States and the Fourteenth Amendment thereto.

21. Counsel for appellant apologize for the length of this motion, but they have earnestly endeavored to present clearly their reasons for believing that the decision of this Court is erroneous, and to show that the decision is in conflict with legal principles heretofore clearly and definitely established. In presentation of the case on oral argument counsel's time was so limited and so largely taken up in answering questions propounded by the Court that it was not possible to present these reasons, which they were prepared to do.

For the foregoing reasons it is respectfully urged that this petition for rehearing be granted, and that the judgment of the District Court be, upon further consideration, reversed.

Respectfully submitted,

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I, James D. Williamson, counsel for the above-named International Shoe Company, do hereby certify that the foregoing petition for rehearing in this cause is presented in good faith and not for delay.

James D. Williamson,
Counsel for International Shoe Company.